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GRAIN INSPECTION

Industry Views on the Decline in Official Inspections and Inspection Costs



149049



United States
General Accounting Office
Washington, D.C. 20548

**Resources, Community, and
Economic Development Division**

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April 30, 1993

The Honorable Thomas A. Daschle
The Honorable Robert Kerrey
The Honorable Patrick J. Leahy
The Honorable Richard G. Lugar
United States Senate

In response to your request and subsequent discussions with Senator Daschle's office, this report presents information on your concerns about the federal grain inspection system. Because the price of grain varies on the basis of its grade and weight, inspection and weighing are critical to grain merchandising to ensure that buyers actually obtain the quality and quantity of grain ordered and paid for. To correct widespread abuses in the quality and quantity of grain delivered in the mid-1970s, particularly for export, the Congress enacted the U.S. Grain Standards Act of 1976. The act established, within the U.S. Department of Agriculture (USDA), the Federal Grain Inspection Service (FGIS) and made the FGIS Administrator responsible for the national grain inspection and weighing system. The act also requires that grain for export be officially weighed and inspected and that FGIS provide for official inspections as an option in the domestic market. Inspections outside the FGIS inspection system are referred to as unofficial.

The 1976 act required that FGIS perform official grain export inspections; supervise state-operated agencies that perform official export inspections under delegations from FGIS; and supervise state-operated and privately owned official inspection agencies designated by FGIS to perform official inspections in the domestic market. The act also required users to pay FGIS and official state and private inspection agencies for the inspections. In turn, the state and private agencies must pay FGIS a fee for its supervision.

You requested that we develop answers to questions about the performance of the system. Specifically, the information presented in this report responds to your questions about the (1) decline in official inspections in the domestic grain market and the impact of that decline, (2) fees that official inspection agencies charge for official domestic inspections, (3) fees that FGIS charges for export inspections, and (4) options for reducing inspection fees. In developing the information, we relied on the views of representatives from government agencies, the industry, and industry associations, including FGIS, USDA's Agricultural Stabilization and Conservation Service (ASCS), merchandisers, processors,

industry associations, official inspection agencies, and unofficial inspection agencies.

Results in Brief

Overall, official domestic inspections performed by the 72 agencies declined by about 19 percent from 1985 to 1992, even though 30 of the agencies performed more official inspections of grain in 1992 than in 1985. The number of metric tons inspected declined by about 10 percent. Industry representatives said that several factors had influenced the decline, including the cost of official inspections and a trend to improved internal quality assurance programs. Moreover, the same representatives said that the decline has not resulted in increases in buyer complaints that sellers are not delivering the quality of grain the buyers purchased.

Official domestic inspection fees vary among the state and private agencies, each operating exclusively in a specified geographical area. For example, the fee for inspecting any size truckload of grain varies from \$5.30 to \$16.55 among the official agencies that perform most official truckload inspections. Thus, for a truck that holds 750 bushels of grain, the fee ranges from .7 cent to 2.2 cents per bushel. In turn, the agencies paid FGIS a supervision fee of 30 cents for each truckload of grain inspected. Overall, FGIS' supervision fees averaged about 5 percent of the 72 agencies' estimated fee charges of \$28 million in 1992.

FGIS' fees for verifying the grade and weight (i.e., official inspection and weighing) of export grain averaged an estimated .47 cent per bushel. The eight states performing identical services charged an average of .41 cent per bushel. For a ship carrying 960,000 bushels of grain, FGIS' fee is about \$4,512. In total, exporters paid FGIS and state inspection agencies about \$17.7 million in 1992 for required export inspections.

Industry representatives said that the fee-setting process needed to be more competitive. Options supported by some include (1) developing a more competitive process for designating inspection agencies to perform official domestic inspections and approving the inspection fees and (2) turning export inspections performed by FGIS over to state and private inspection agencies. Some of the options can be considered and acted on by FGIS; others cannot because the law does not give FGIS any discretion.

Background

Following widespread disclosures of misgrading and "shortweighing" of grain in the mid-1970s, particularly of export grain, the Congress amended

the U.S. Grain Standards Act (USGSA) (7 USC 71-87) by enacting the U.S. Grain Standards Act of 1976 to reform the system. In sum, the 1976 act vested in the FGIS Administrator the responsibility for promoting, facilitating, and regulating the merchandising of U.S. grain in an orderly, objective, and timely manner by establishing official standards for grain and uniformly applying those standards through a system of official inspection.

U.S. grain generally moves from the farm to domestic users and to export ports for shipment to foreign buyers through a system of grain elevators by three modes of transportation—truck, rail, and barge. The elevators are owned by individuals, farmers' cooperatives, or grain companies and are located in rural farming communities (country elevators), at principal grain marketing centers (inland terminals), and at export locations (export elevators). Since the mid-1970s the proportion of grain that passes through traditional grain marketing centers has decreased. More grain is now being shipped directly from production areas to cattle feeders, domestic processors, and the ports.

As grain changes ownership in moving from the farmer to the end-user, third-party inspections (official or unofficial) may be used to independently establish or verify the grade of grain. The value of an official inspection is enhanced by the USGSA (7 USC 79(d)), which states that the grading results shown on official inspection certificates shall be received by all officers and all courts of the United States as prima facie evidence of the truth of the facts stated therein.

Grain standards and sound procedures for drawing samples and for grading are critical for accurately judging the quality of grain. In accordance with the USGSA, FGIS establishes standards for judging each of 12 types of grain and publishes procedures for drawing samples and grading. The standards consist of a group of grading factors; a grade is assigned on the basis of the results of analyses of the several factors.

Wanting to ensure that the quality of grain exported is correctly represented, the Congress in the 1976 act required that shipments of grain of a specified grade for export be inspected and weighed at the export terminal. FGIS performed about 82 percent of the export inspection and weighing in 1992.¹ FGIS may also delegate its authority to state government agencies to perform the services under FGIS' supervision, if the agencies

¹Unless otherwise noted, all years presented in this report are fiscal years.

meet specified requirements of the act. Under delegations from FGIS, eight state agencies perform export inspection and weighing services.

Although the 1976 act made official inspections of grain optional in the domestic market, the act authorizes FGIS to designate private and state agencies to offer and perform official inspections in the domestic market. FGIS has designated 72 official agencies (20 state and 52 private), each of which operates in an exclusive geographical area.

To ensure consistency in the grading of grain throughout the official inspection system, FGIS monitors both the export and domestic inspection process. First, FGIS and each official agency must use qualified personnel to perform the inspections, follow FGIS-established procedures for sampling and grading grain, and use FGIS-approved equipment. Second, FGIS supervises the official inspection system, which includes staff visits to observe inspection and weighing. Third, after FGIS' and official agencies' staff have inspected and graded grain, FGIS regrades some samples to ensure that the original grading was accurate. Also, FGIS' oversight of its staff who oversee the official inspections includes regrading some samples of the staff's regrading.

In addition to the official inspection and grading service, FGIS and the official agencies provide other types of services, including measuring wheat and soybean protein content and soybean oil content, as well as measuring for the presence and amount of aflatoxin. Other FGIS responsibilities include investigating the handling, weighing, grading, and transportation of grain. Also, under the Agricultural Marketing Act (AMA) of 1946 (7 USC 1621 et seq.), the Secretary of Agriculture has delegated to the FGIS Administrator responsibility for developing inspection and weighing standards and for inspecting specified commodities (rice, pulses, beans, and processed grain products, such as flour and corn meal). FGIS collects fees to cover its costs of performing inspections performed under AMA.

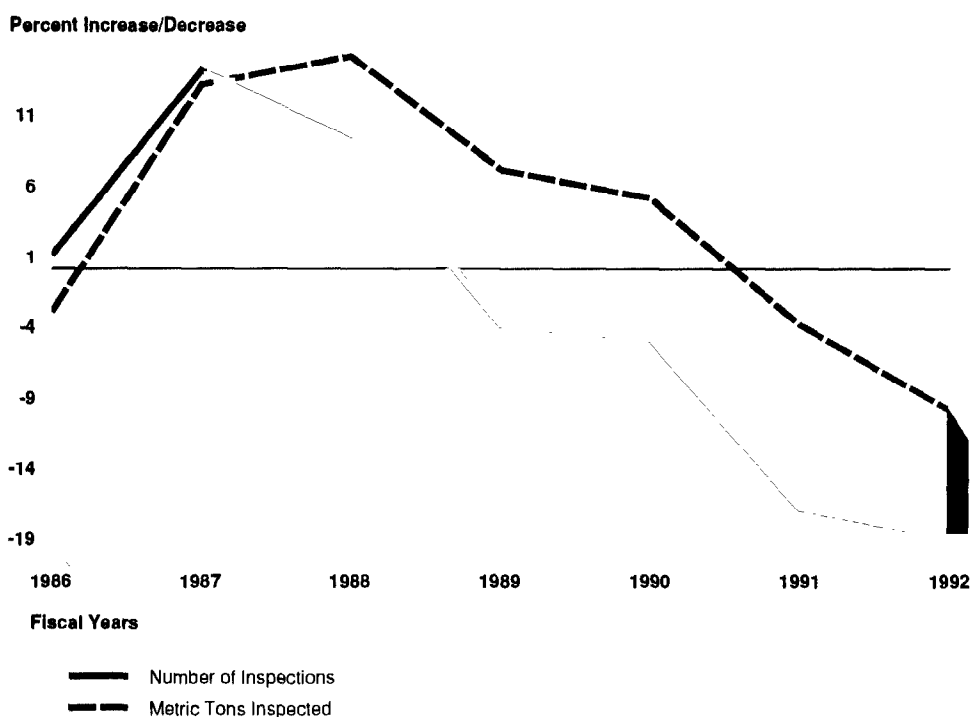
For 1992, FGIS' expenditures totaled \$40.5 million. Fee income for its supervision and services totaled about \$29 million. (See app. I for more information on FGIS' organization and funding.)

Decline of Official Inspections in the Domestic Market

From 1985 to 1992, the most recent period for which FGIS has separate data for domestic inspections, the number of official domestic inspections performed by official inspection agencies varied from year to year. Of the 72 official agencies, 30 performed more official inspections in 1992 than in

1985. Overall, however, the number of inspections declined from about 2.7 million to 2.2 million, or about 19 percent. During the same period the number of total metric tons inspected declined from about 152 million to 137 million, or about 10 percent. The percentage of change in the number of inspections and metric tons inspected since 1985 is shown in figure 1.

Figure 1: Percentage of Change in Number of Official Domestic Inspections and Metric Tons Inspected by Official Agencies Since Fiscal Year 1985



Our interviews with government and industry representatives indicated that several factors, in addition to cost, have contributed to the changes in demand for official domestic inspections, beginning in the 1970s. First, consolidations in the grain industry have reduced the number of times the ownership of grain changes hands from the farmer to the end-user; fewer changes in ownership require fewer third-party inspections. Second, grain merchandisers pointed out that there is a trend to "in-house" grading, prompted by cost considerations and the need for internal quality assurance programs. Third, merchandisers and end-users stated that buyers have greater confidence than in past years that sellers will deliver the quality of grain agreed upon and work out acceptable solutions in

those instances in which problems occur. Fourth, ASCS, which manages the government's grain inventories obtained under farm commodity programs, has changed the way it manages its inventories and has substantially lower grain acquisitions, which has resulted in fewer movements of grain.

The decline in demand for domestic inspections has not harmed the integrity of grain merchandising, according to industry representatives that we interviewed. That is, they do not believe that the decline has resulted in increased buyer complaints that sellers are not delivering the quality of grain that buyers purchased. One grain association's representatives said that the number of arbitration cases has not increased in recent years, which is one indication that the integrity of grain transactions has not been harmed.

Although they cannot quantify the effect of the decrease in official inspections, FGIS representatives believe that integrity has not been compromised because the official system serves as a safety net for the unofficial system. According to FGIS, unofficial agencies obtain regrading of samples from official agencies to measure the accuracy of their grading and for purposes of settling disputes between buyer and seller, when an official inspection was not initially obtained. In addition, FGIS pointed out that, where crop conditions are poor, making the inspection function more difficult, users and unofficial agencies request more inspections than they normally do.

The major benefits of official inspections, according to industry representatives, are that the inspection is performed by an independent third party and the grading results are highly reliable. Nonetheless, those we interviewed were unanimously opposed to amending the USGSA to require official domestic inspection. They said that each user is in the best position to judge the cost and benefits of a third-party inspection and whether the third-party should be an official inspection agency. (See app. II for more information on the decline of official domestic inspections and the impact of that decline.)

Fees for Official Domestic Inspections

The 72 official domestic inspection agencies charged their users an estimated \$28 million (excluding variable charges) for 2.2 million official inspections in 1992. Each official agency sets its own fees, although FGIS must initially approve agencies' fee schedules as well as any changes. The official agencies paid FGIS about \$1.5 million for its supervision in 1992, or an average of about 5 percent of the total fees they charged.

The official agency fees, as of November 1992, varied widely for the same inspection service even when comparisons are limited to those agencies performing most of a particular type of inspection. Because some inspection agencies perform fewer inspections of a particular type than others, we compared fees for agencies performing the vast majority of each type of inspection to minimize any differences in fees that might be related to the volume of inspections. Table 1 shows the range of fees. Collectively, the agencies included in the analysis account for about 90 percent of each type of inspection performed by all agencies combined.

Table 1: Range of Fees Charged by Official Agencies Performing Most of Each Type of Inspection

Type of Inspection	Number of agencies	Range of agencies' fees ^a		Weighted average of all agencies	FGIS' fees
		Low	High		
Truck	11	\$5.30	\$16.55	\$9.59	\$.30
Rail car	30	9.45	23.70	15.15	.95
Barge	17	122.27	184.15	153.98	6.15
Submit ^b	25	4.30	10.80	6.70	.30

^aThe fees shown do not include any additional variable charges for travel time or mileage to draw the sample.

^bSubmits are samples drawn and submitted by a customer.

The variance in fees was greatest for trucks. The range of \$5.30 to \$16.55 amounts to a range of .7 cent to 2.2 cents per bushel for a truck that holds 750 bushels of grain.

Official agency inspection fees vary widely even among agencies operating in adjacent areas. FGIS' regulations require that each agency's fees be reasonable and supported by cost data. Nonetheless, the fees charged by official agencies serving contiguous areas varied considerably. For example, one agency charged \$23.70 for inspecting a rail car of grain, while agencies operating in adjacent geographic areas charged from \$9.45 to \$18.20.

While an association representing some of the official agencies suggested that dropping the FGIS fee would enable the agencies to offer more competitive fees, most official inspection agency representatives that we interviewed did not indicate that this fee is a major problem. The FGIS fee for supervision does not include its total cost of oversight. Following its regulations, FGIS does not include in the fee the cost of (1) regrading samples of grain graded by the official agencies to verify the accuracy of

the grading and (2) FGIS' annual management review. FGIS' costs for these oversight activities, which it pays from appropriated funds, totaled \$2.57 million for 1992.

Recognizing that its procedures governing an official inspection might be too stringent and costly to meet some of the needs of potential domestic customers, FGIS developed an alternative—the new official commercial inspection. This new inspection, approved in April 1992, allows agencies to tailor inspections to the customers' needs. FGIS also believed that the new inspection would enable the official agencies to better compete with the price of unofficial inspections; it estimated that fees for the new inspection should be from 10 percent to 40 percent below the standard fees. Some official inspection agencies' representatives explained that the official commercial inspection enabled them to obtain inspection business that they would not have otherwise attracted. Use of the new inspection had increased to about 5 percent of the total domestic inspections by early 1993. However, many industry representatives that we interviewed were unfamiliar with the inspection. (See app. III for more information on official domestic inspection fees.)

FGIS Fees for Export Inspections

For exported grain valued at about \$14.5 billion, exporters reimbursed FGIS and state government agencies about \$17.7 million for inspection and weighing in 1992; these charges were for services specifically required by the USGSA for exports. FGIS fees for these services averaged an estimated .47 cent per bushel. The eight state agencies' fees for these same services ranged from three-tenths to nine-tenths of a cent per bushel and averaged .41 cent per bushel. For a ship carrying 960,000 bushels of grain, FGIS' fee is about \$4,512.

Our review of FGIS' accounting records indicates that direct costs charged to the FGIS services-performed account for 1992, which is predominantly FGIS' export inspection activity, were appropriate. However, FGIS used a questionable methodology to allocate indirect costs. The methodology includes averaging several unweighted percentages as a part of the allocation process. If the percentages had been weighted by the dollar value of the universe they represented, the indirect charges to the FGIS services-performed account would have increased by \$695,000. In view of our disclosure, the FGIS Acting Administrator said that the agency would review its methodology for allocating indirect costs. (See app. IV for more information on official export inspection fees.)

Potential Options for Reducing Inspection Fees

Industry representatives suggested that the solution to reducing fees for official inspections is to introduce more competition into the fee-setting process.

Domestic Inspection Fees

Some industry representatives suggested that FGIS could make the periodic chartering of official domestic agencies and approving fee increases more competitive.

In accordance with the USGSA (7 USC 79(g)(1)), FGIS issues a charter for a period of up to 3 years to state and private agencies performing official domestic inspections. The charter authorizes the agencies to perform official inspections exclusively in a specified geographical area. As the end of the charter period approaches, FGIS invites and considers applications from interested parties before issuing a new charter or renewing an existing charter. Although FGIS solicits applications for each designated area as charter expirations approach, competition has been limited, and the incumbent has usually been chartered for another 3 years, unless the incumbent has had major performance problems. When each of the 72 charters last came up for renewal, only 13 had applications from other than the incumbent.

Some industry representatives have stated that they would be supportive if FGIS introduced more price competition into the process for setting official domestic inspection fees by (1) more actively encouraging applications when a charter is up for award and placing greater emphasis on the reasonableness of fees both in evaluating the incumbent's performance and selecting the designated agency and/or (2) eliminating exclusive territories.

One large merchandiser said that, while he supports more competitive official fees, he is not sure that he would like to see ownership of official agencies changing every 3 years if that would be the outcome of a more competitive system. He said that there are some merits in having stable ownership and building good working relationships with the industry.

FGIS can consider and, if it deems appropriate, place greater emphasis on fees when chartering agencies. However, the USGSA (7 USC 79(f)(2)) requires that the official agencies operate in an exclusive geographical area. This provision reflected agency practice at the time the act was amended. According to a FGIS representative, the provision was designed to encourage official agencies to develop customers throughout their

designated area without the threat of competition from other official agencies.

FGIS is concerned that any increased regulatory effort on its part to oversee official agencies' fees could be viewed as setting rates, which would result in additional regulatory requirements. FGIS does not view additional regulation as desirable. (See app. III for more information on reducing domestic inspection fees.)

FGIS' Export Inspection Fees

Because industry representatives believe, and FGIS generally agrees, that FGIS is limited in further reducing its fees for export inspections, they suggest that FGIS turn export inspection and weighing activities over to state-operated and privately owned official agencies.

Although the USGSA precludes FGIS from turning export inspection and weighing over to a number of state-operated agencies and to any privately owned inspection agencies, FGIS representatives said that doing so is conceptually feasible. Because FGIS would still have the supervisory authority over official agencies provided to it by the 1976 act, FGIS representatives believe that they could prevent a recurrence of the inspection and weighing abuses that occurred in the 1970s. However, whether such a change would produce any savings to exporters is unclear because no comparative cost study has been made. FGIS representatives said that FGIS' supervision fees would have to be added to state and private inspection fees, which could increase the combined costs above those FGIS now charges.

FGIS opposes the further delegation of export inspection and weighing to state-operated and privately owned inspection agencies at the major export locations now serviced by FGIS. FGIS pointed out that the current user-fee arrangement has been in place for 17 years and that during that period FGIS has developed a streamlined inspection and weighing process resulting in a high level of productivity. Furthermore, FGIS does not believe state and private agencies could perform the services at less cost. (See app. IV for more information on reducing FGIS' export inspection fees.)

We discussed the facts in this report with the FGIS Acting Administrator and his staff, other USDA staff, and representatives of the American Association of Grain Inspection and Weighing Agencies, Millers' National Federation, National Grain and Feed Association, and Terminal Elevator

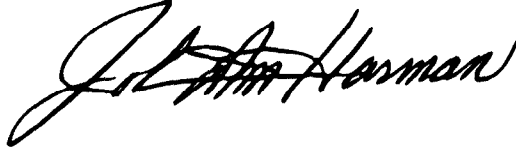
Grain Merchants Association. FGIS officials generally concurred with the information presented and we have incorporated their comments, as well as the views of the other four groups, where appropriate. As agreed, we did not request written agency comments on a draft of this report.

We conducted our work between May 1992 and March 1993 in accordance with generally accepted government auditing standards. To obtain information for this report, we relied on the views of industry, associations, and government agency representatives. In addition to interviewing representatives of FGIS and ASCS, we interviewed representatives from 12 grain producer associations; 7 grain merchandisers (ranging from local to international in scope of operations); 5 processor associations; 4 processors; 2 general industry associations; 13 official inspection agencies; 8 unofficial inspection agencies; and 1 association representing the official inspection agencies. (See app. V for a list of the associations whose representatives we interviewed.)

We also reviewed the USGSA (7 USC 71-87), the AMA (7 USC 1621 et seq.), the U.S. Warehouse Act (7 USC 241-273), and prior GAO reports. In addition, we analyzed FGIS' data bases containing information on domestic and export inspections to develop various information and estimates contained in this report. We did not independently verify the data base information provided by FGIS. To determine whether FGIS appropriately allocated costs to appropriated fund or reimbursable accounts, and whether it appropriately allocated reimbursable costs between domestic and export activities, we reviewed selected FGIS' accounting records.

We will send copies of this report to interested Members of Congress and other interested parties. We will also make copies available to others upon request.

If you have any questions, please contact me at (202) 512-5138. Major contributors to this fact sheet are listed in appendix VI.

A handwritten signature in black ink, appearing to read "John W. Harman". The signature is fluid and cursive, with the first name "John" being the most prominent.

John W. Harman
Director, Food and
Agriculture Issues

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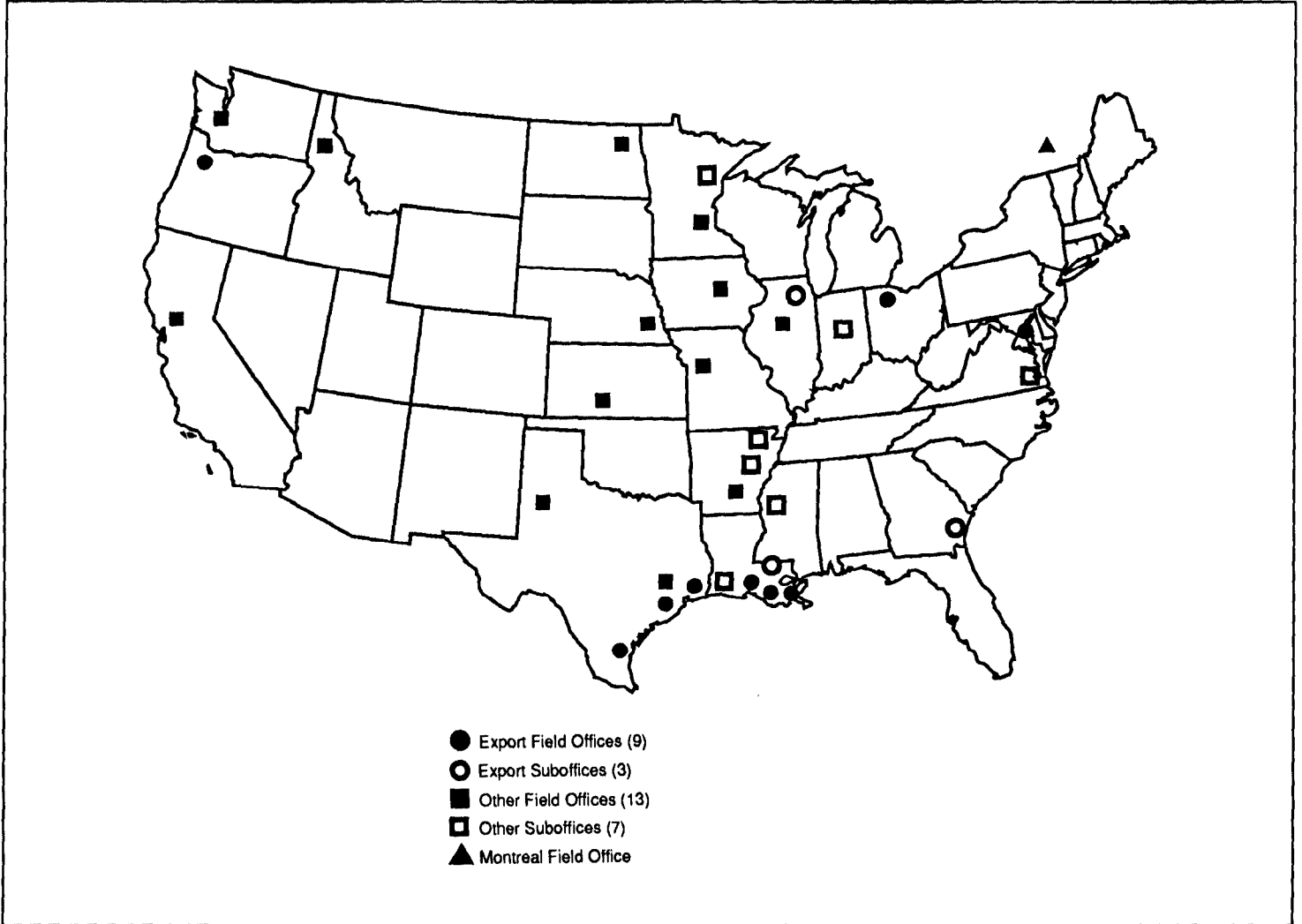
AAGIWA	American Association of Grain Inspection and Weighing Agencies
AMA	Agricultural Marketing Act
ASCS	Agricultural Stabilization and Conservation Service
FDA	Food and Drug Administration
FGIS	Federal Grain Inspection Service
GAO	General Accounting Office
USGSA	U.S. Grain Standards Act
USDA	U.S. Department of Agriculture

FGIS' Organization and Funding

The Federal Grain Inspection Service (FGIS) carries out its mission through three headquarters divisions in Washington, D.C., one division in Kansas City, Missouri, and a number of field offices. As shown in figure I.1, FGIS has 9 field offices and 3 suboffices that primarily perform export inspections and 13 other field offices and 7 suboffices.¹ Although the export offices primarily perform official inspections and weighing of grain under the U.S. Grain Inspection Act (USGSA) at export elevators, some also supervise official agencies or are involved in the Agricultural Marketing Act (AMA) inspection program. The other field offices and suboffices supervise official agencies or are involved in the AMA program. In addition to the domestic and export field offices, FGIS also maintains an office in Montreal, Canada, to inspect and weigh grain transshipped through Canadian grain elevators. As of February 20, 1993, FGIS had 644 permanent, full-time employees. About 80 percent of FGIS' employees are located in the field offices.

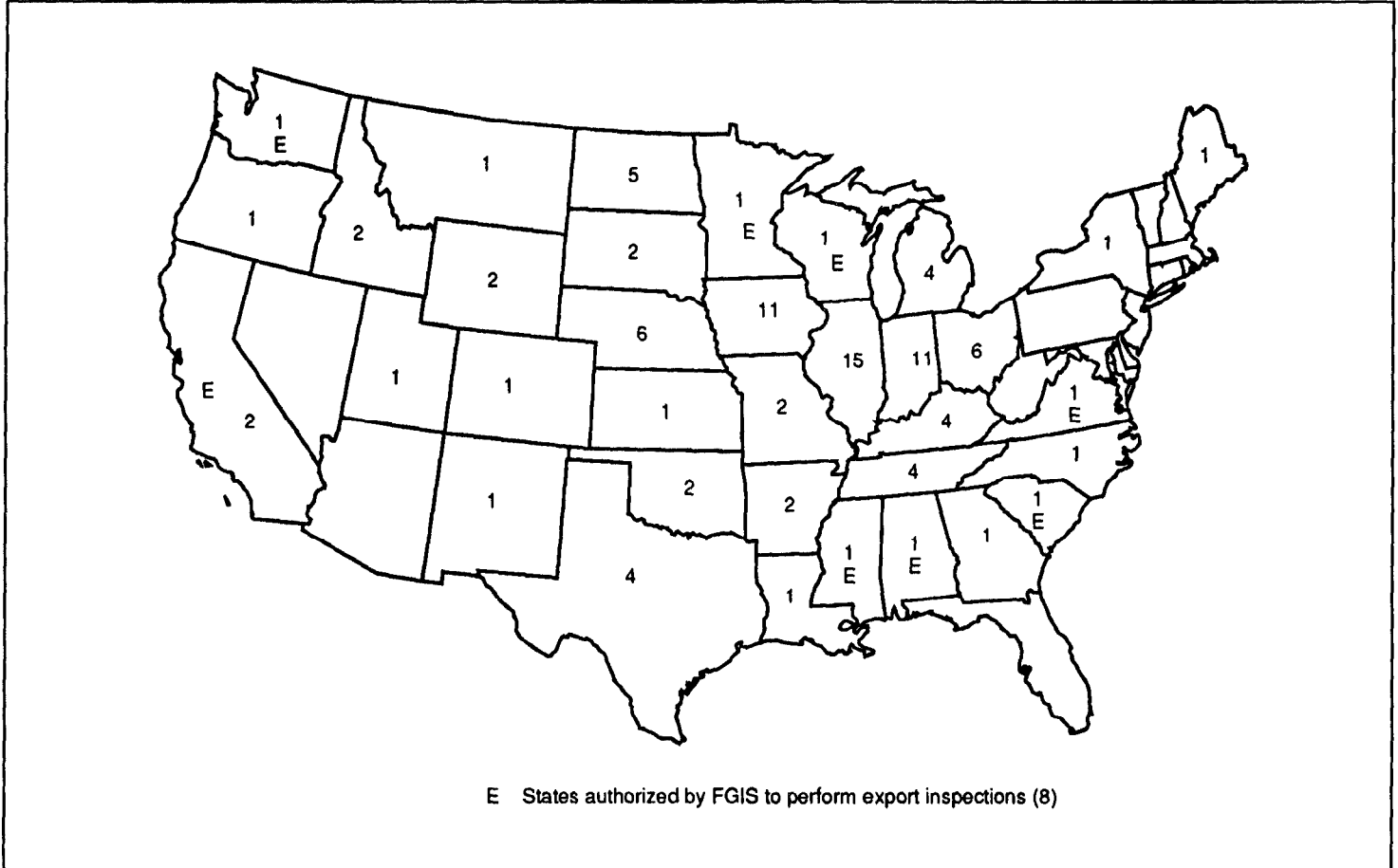
¹Our classifications differ from those used by FGIS; we classified and counted offices by function, whereas FGIS classifies and counts offices by administrative alignment.

Figure I.1: Location of FGIS' Field Offices



In total, 72 state and private inspection agencies perform official domestic inspections, export inspections, and/or weighing services. Of these, 51 private and 20 state inspection agencies perform official domestic inspections and/or weighing services, and 1 private agency performs weighing services only. Eight of the state agencies also perform export inspections. As shown in figure I.2, the number of official agencies operating in each state varies from zero to 15.

Figure I.2: Number of Official Inspection Agencies Operating in Each State



Note: The number of official agencies shown will exceed the total official agency count because some agencies have service territories that overlap state boundaries. Alaska (1 agency) is not shown.

FGIS recoups through fees the cost of performing and supervising official inspections. Although FGIS performs most of the AMA inspection work, it has cooperative agreements with state agencies in 20 states to perform some grading or sampling work. Fees collected for performing the AMA inspection work pay the costs of those activities.

FGIS' operational costs are managed through both appropriated and trust funds. Activities for which appropriated funds are used include developing

**Appendix I
FGIS' Organization and Funding**

grain standards, sampling procedures, investigating alleged wrongdoing, and performing quality assurance functions pertaining to oversight of FGIS inspections and state and private official inspection agencies. Fee income, which is processed through trust funds, includes charges for services performed (e.g., export inspection and weighing, and appeal inspections), supervision of official agencies, and registration of exporters. FGIS periodically reviews its fee charges to ensure that they are sufficient to cover its expenses for each fee income program. As shown in table I.1, FGIS' operating budget includes nine programs, three paid from appropriated funds and six paid from fee income. About 72 percent of FGIS' 1992 expenditures were funded from fee income.

Table I.1: FGIS' Expenses and Fee Income for Fiscal Year 1992

Thousands of dollars		
Fund/program title	Expenses	Fee Income
USGSA trust funds		
FGIS services performed	\$18,814	\$19,074
FGIS supervision of official agencies	1,443	1,577
Montreal, Canada, office	299	264
Registration of exporters	9	16
Subtotal	\$20,565	\$20,931
USGSA appropriated funds		
Standardization	\$7,216	\$0
Compliance activities	3,555	0
Subtotal	\$10,771	0
Total—USGSA	\$31,336	\$20,931
AMA trust funds		
Rice inspections	\$3,347	\$2,870
Other commodity inspections	5,338	5,159
Subtotal	\$8,685	\$8,029
AMA appropriated funds		
Standardization	461	0
Total—AMA	\$9,146	\$8,029
Total USGSA and AMA	\$40,482	\$28,960

Decline of Official Inspections in the Domestic Market and Impact of the Decline

This appendix responds to the specific questions raised by the requesters concerning the decline in official inspections in the domestic market and the reasons for and the impact of the decline. The questions are:

- What causes users to select an official inspection?
- To what extent have official inspections declined?
- Why has the use of official inspections declined?
- Who are the unofficial inspectors?
- Are unofficial inspectors benefiting from the official system without contributing to its support?
- Has the decline in official inspections harmed the integrity of grain industry transactions?
- Has the decline in domestic official inspections harmed the integrity of shipments to export terminals?
- Would further decline in official inspections harm the domestic grain industry?
- Do users believe official inspections should be mandatory?

What Causes Users to Select an Official Inspection?

Several industry representatives said that the major benefits of an official inspection are that it is performed by an independent third party and/or that the grading results are highly reliable. The USGSA (7 USC 79(d)) states that the grading results shown on official inspection certificates shall be received by all officers and all courts of the United States as prima facie evidence of the truth of the facts stated therein.

According to the representatives of the two large grain merchandisers we interviewed, they generally use third parties to make domestic grain inspections when they need an independent determination of grain quality. Third-party inspections may be required when dealing with a new buyer or seller or when the financial risks (e.g., long-distance delivery) make it desirable to get a third-party verification of grade or other quality factors before shipment. According to one large merchandiser, when a third-party inspection is desired, his firm will normally use official inspection agencies when their costs are lower than an unofficial agency's. The other large merchandiser said that when his firm needs third-party inspections, it will normally use official inspection agencies because of their generally accepted reliability.

Several merchandisers said they mostly rely on in-house grading and use the official system only when required by a buyer or seller or to resolve a dispute over grade. Some smaller grain merchandisers and producers'

**Appendix II
Decline of Official Inspections in the
Domestic Market and Impact of the Decline**

associations said that they have generally not used official domestic inspection agencies because the services were too costly or not readily available.

Some grain processors generally rely on in-house grading, while others said they use a third-party unofficial agency to grade in-bound grain. The circumstances under which processors generally use an official inspection include when they receive grain from a new supplier or the other party requires it.

**To What Extent Have
Official Inspections
Declined?**

Because FGIS retained official domestic and export inspection information in a combined form through 1985, we analyzed the combined data for both the domestic and export markets for the period from 1980 through 1992. Although the number of inspections declined by 46 percent from 1980 to 1992, the total number of metric tons inspected declined by only 11 percent. Table II.1 shows data on the inspections.

Table II.1: Total Numbers of Official Domestic and Export Inspections and Metric Tons Inspected, Fiscal Years 1980 to 1992

Fiscal year	Inspections		Metric tons	
	Number	Percent Increase (decrease) since 1980	Number	Percent Increase (decrease) since 1980
1980	4,411,164		278,500,000	
1981	3,936,518	(11)	306,200,000	10
1982	3,110,576	(29)	303,700,000	9
1983	2,964,812	(33)	291,000,000	4
1984	2,955,772	(33)	294,400,000	6
1985	2,959,877	(33)	269,100,000	(3)
1986	3,022,436	(31)	247,600,000	(11)
1987	3,336,325	(24)	296,800,000	7
1988	3,200,379	(27)	311,000,000	12
1989	2,819,625	(36)	297,500,000	7
1990	2,794,971	(37)	291,000,000	4
1991	2,422,704	(45)	254,800,000	(9)
1992	2,364,326	(46)	247,300,000	(11)

Available FGIS information for official domestic inspections shows that the number of inspections declined by about 19 percent from 1985 to 1992. However, as shown in table II.2, the total tonnage inspected declined by about half that amount. As shown in table II.3, the number of metric tons

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inspected decreased at a lower rate than the number of inspections because of changes in the mix of inspections. The number of inspections for rail cars transporting grain was greater in 1992 than in 1985. Samples submitted to an official agency for inspection accounted for most of the decline in inspections, followed by inspections of grain transported by trucks and barges.

Table II.2: Total Numbers of Official Domestic Inspections and Metric Tons Inspected by Official Agencies, Fiscal Years 1985 to 1992

Fiscal Year	Inspections		Metric tons	
	Number	Percent Increase (decrease) since 1985	Number	Percent Increase (decrease) since 1985
1985	2,692,661		152,246,527	
1986	2,710,696	1	147,506,564	(3)
1987	3,071,179	14	172,591,628	13
1988	2,934,696	9	174,810,526	15
1989	2,572,576	(4)	163,630,359	7
1990	2,559,225	(5)	159,280,149	5
1991	2,228,685	(17)	145,785,818	(4)
1992	2,168,063	(19)	137,436,699	(10)

Table II.3: Total Numbers of Official Domestic Inspections by Type Inspection and Total Tons Inspected by Official Agencies, Fiscal Years 1985 to 1992

Fiscal year	Inspections				Total no. of inspections	Total no. of metric tons inspected
	Truck	Rail car	Barge	Samples submitted		
1985	594,712	893,926	37,265	1,166,758	2,692,661	152,246,527
1986	536,428	933,195	31,483	1,209,590	2,710,696	147,506,564
1987	553,568	1,164,663	35,089	1,317,859	3,071,179	172,591,628
1988	514,048	1,227,698	35,891	1,157,059	2,934,696	174,810,526
1989	416,099	1,125,772	37,408	993,297	2,572,576	163,630,359
1990	451,208	1,122,475	34,347	951,195	2,559,225	159,280,149
1991	403,115	983,110	35,184	807,276	2,228,685	145,785,818
1992	426,330	961,979	30,512	749,242	2,168,063	137,436,699

Note: For truck, rail car, or barge, the official agency draws the sample and grades it; the results are applicable to the universe from which the sample was drawn. For samples drawn and submitted by the customer, the official agency grades the sample, but the results are applicable only to the sample.

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Although the number of official domestic inspections declined overall during the period from 1985 to 1992, many agencies increased the number of inspections they performed during this period. As shown in table II.4, 30 agencies had increases totaling 225,178 inspections, while 40 agencies had decreases of 674,829.

Table II.4: Number of Agencies With Increases in Domestic Inspections Since Fiscal Year 1985 and Number With Decreases

Number of Inspections performed in 1992	Agencies with Increases		Agencies with decreases	
	Number	Combined Increases	Number	Combined decreases
Over 100,000	2	44,572	2	34,329
75,001-100,000	0	0	2	43,901
50,001-75,000	6	80,548	4	96,509
25,001-50,000	3	32,139	8	147,815
25,000 or less	19	67,919	24	352,275
Total	30	225,178	40	674,829

Note: Excludes two agencies that did not perform any inspections in 1992.

Why Has the Use of Official Inspections Declined?

Although we could not quantify the extent to which each of several changes has influenced the decline in official domestic inspections, both government and industry representatives highlighted the following reasons for the decline:

- Large grain companies have absorbed smaller independent merchandisers as well as processing plants, which increases intracompany grain transactions and decreases the number of times the ownership of grain changes hands between the farmer and the end-user.
- Industry trend toward using “in-house” inspectors.
- Changes in the way the Agricultural Stabilization and Conservation Service (ASCS) manages its inventory and its substantially lower grain inventories results in fewer dispositions of grain. ASCS manages the government’s grain inventories accumulated under farm commodity loan programs.

As large grain companies absorb smaller independent merchandisers and processing plants, the need for third-party official inspections is reduced. The reduction occurs because ownership of the grain changes hands fewer times as it moves from one storage location to another and from the producer to the end-user. For example, a 1991 study showed that the combined storage capacity of the 10 largest grain elevator companies more

than doubled from 1981 to 1990. The 10 largest grain elevator companies in 1981 had a combined capacity of 721 million bushels of storage capacity, whereas the 10 largest in 1990 had a combined capacity of 1,579 million bushels.¹ The three companies having the largest elevator capacity are also the three largest flour millers, primarily because they acquired milling companies in recent years.

Most grain merchandisers that we interviewed stated that the trend to "in-house" grading was prompted by cost considerations and the need for internal quality assurance determinations. Some said that the internal quality assurance controls were needed to ensure that grain they received or delivered would meet grade and other specifications. They said that some merchandisers and processors have developed highly reliable in-house controls, thereby enabling buyers and sellers to build trusting relationships with each other and reduce the need for third-party inspections.

An ASCS representative stated that the agency's use of the official system has decreased considerably because of changes in the way it manages its inventories and decreases in the amount of grain that ASCS has to merchandise. To substantially reduce transportation costs in the late 1980s, ASCS began "swapping grain," i.e., trading grain at one location with the owner of grain at another location that better served ASCS' merchandising plans. By trading grain, ASCS reduced the need to move grain, which in turn reduced the need for official inspections. In addition, the amount of grain that ASCS obtains each year, from forfeiture of grain by producers under the income support program, has decreased substantially.

The American Association of Grain Inspection and Weighing Agencies (AAGIWA), whose members include 42 of the 72 official inspection agencies, believes that a contributing factor to the decline in domestic official inspections is competition from unofficial inspections, performed by in-house inspectors and unofficial agencies. Some grain industry representatives agree that some of the decline is due to the cost of official inspections; one trade association representative stated that in-house grading could be performed in some locations for substantially less than the cost of an official inspection. However, the association did not provide any support for the example. One unofficial agency representative stated

¹Reynold P. Dahl, "Structural Changes in the United States Grain Marketing System," University of Minnesota, Institute of Agriculture, Forestry and Home Economics (St. Paul, Minn.: Sept. 1991).

that some of its customers that previously used official agencies have changed because of the cost or service provided.

In addition, AAGIWA stated that the FGIS memorandum of understanding with the Food and Drug Administration (FDA), requiring that certain types of grain contamination² identified during official inspections be reported to FDA, encourages potential users to avoid the official inspection system. Grain industry representatives generally stated that, in their opinion, any avoidance of the official system because of concern about the reporting requirement was minimal. Most official inspection agency representatives that we interviewed said they did not think avoidance occurred all that frequently. Processors stated that they would not avoid the official inspection system because of the reporting requirement; they are concerned that nothing contaminated gets into their products. One processor pointed out that it regarded its liability to the consumer as a much greater threat than any official inspection agency report to FDA.

AAGIWA recommended that all inspectors—official or unofficial—be required to report contamination to FDA. Several industry representatives generally stated that such a requirement would be acceptable to them.

Who Are the Unofficial Inspectors?

Unofficial inspectors can range from “in-house” graders at elevators and grain processing plants to third-party inspection agencies and laboratories. In our interviews throughout this review, we asked for assistance in identifying as many unofficial agencies as possible. We identified 16 unofficial agencies, 6 located in interior cities and 10 in port cities. We interviewed representatives of 8 of the 16 agencies; 4 performed inspections primarily at export and 4 performed domestic inspections.

The four unofficial agencies generally serving the export market are performing services for grain merchandisers and overseas buyers. These agencies’ representatives explained that they are full-range agricultural laboratories conducting various types of tests on products ranging from crude vegetable oil to fully refined oil; the various tests include those for aflatoxin, pesticide residues, radioactivity, by-products, and heavy metals. One representative estimated that one-third of the grain exported is inspected by unofficial agencies, in addition to the USGSA-required inspection. The agency representatives said they were generally testing for substances for which FGIS does not have official tests (e.g., pesticide

²For example, animal filth, aflatoxin, foreign matter such as glass or metal, insect damage to wheat, and objectionable odors.

residues) or performing other services that generally are not included in an official export inspection. In addition, some said they were testing for aflatoxin, for which FGIS has an official test. Also, some said they were regrading (cross-checking FGIS' and states' official inspection results) for their customers to ensure that the FGIS grading was correct.

The four unofficial agencies providing domestic inspections include two agencies that were previously official agencies—one prior to the 1976 amendments establishing FGIS and one subsequent to that time. Three of these agencies generally serve a part of a state, while the fourth provides services on a national basis. Their customers generally are country elevators and processors. Three offer testing services for substances for which FGIS does not have an official test, such as pesticide residues.

Unofficial inspectors also include those individuals licensed to inspect grain by ASCS. As a part of ASCS' management of the government's grain inventories accumulated under farm commodity loan programs, ASCS has certain responsibilities under the U.S. Warehouse Act (7 USC 241-273). The act makes ASCS responsible for protecting producers' and the government's grain stored in elevators across the country. The act requires ASCS both to license warehouses for storing government-owned grain inventories and to license the inspectors who do the grading at the warehouses. However, ASCS' regulations require that inspection certificates issued under the act clearly state that the certificates are not valid for purposes of the USGSA.

Are Unofficial Inspectors Benefiting From the Official System Without Contributing to Its Support?

FGIS believes that unofficial agencies receive benefits from the official inspection system that are greater than the financial support they provide. The unofficial agencies obtain some information from the official system at little or no cost, just as others do, and pay for other services.

Although unofficial agencies receive some benefits from the FGIS official inspection system at little or no cost, FGIS makes the same benefits available to the public and the official agencies also at little or no cost. The benefits include

- FGIS-developed grain standards;
- FGIS handbooks on sampling and grading procedures;
- identification of FGIS-approved sampling and grading equipment, which is available from vendors to any buyer; and

- grain sampling and grading courses open to the public, which FGIS participates in.

While unofficial agencies pay for some services received from the official system, FGIS believes that the benefits to unofficial agencies are greater than the cost to them. FGIS, official agency, and unofficial agency representatives said that unofficial agencies use the official system as a quality control tool. For example, unofficial inspectors submit samples they have graded to an official inspection agency for regrading. FGIS' position is that the inspection results enable the unofficial inspectors to determine whether they are accurately grading grain and whether their grading equipment is performing accurately. Thus, the inspection results enable unofficial agencies to make adjustments necessary to their operations to provide accurate and relatively standardized inspection results to their users. However, while the unofficial inspection agency must pay the established price for any particular inspection obtained from an official agency, the official agency is available to make such inspections because of the continuing work load provided by its customers and not because of the few inspections from unofficial agencies.

Has the Decline in Official Inspections Harmed the Integrity of Grain Industry Transactions?

The consensus of opinion of industry representatives that we interviewed is that the decline in official inspections has not harmed the integrity of domestic grain transactions; that is, they do not believe that the decline has resulted in increased buyer complaints that sellers were not delivering the quality and quantity of grain that the buyer purchased. Although they cannot quantify the effect of the decrease in official inspections, FGIS representatives said they believe that integrity has not been compromised.

Producer association representatives indicated that they were generally satisfied that grain they delivered for storage or sale was properly graded by the receiving party (e.g., an elevator, processor). Merchandisers and processors said they had not noticed any decline in the integrity of grain transactions. Several said that, because of internal grading controls, they were able to identify any deviations in grading and take corrective action (e.g., improve their in-house grading or require the supplier to improve its grading) so that deviations were not a continuing problem.

According to representatives of two grain trade associations, there is no evidence that the use of unofficial inspections has had any negative impact on the integrity of grain transactions. Representatives of one of these associations said that they had not seen any increase in the number of

arbitration cases between buyers and sellers over differences in grain quality at origin and destination. They also said that if users of in-house graders or unofficial agencies found that the grades assigned were not accurate, they would take appropriate action, such as resolving the difference with the other party or finding another source for grading.

Some unofficial agency representatives indicated that they, too, had a vested interest in maintaining the integrity of grain transactions. They said that they would not stay in business if they did not accurately grade grain. All eight said that they followed FGIS' sampling procedures and grading procedures and used FGIS-approved equipment. However, one representative said that his agency does not require as many grams in each sample as FGIS' procedures require.

FGIS representatives said that integrity has not been compromised because the official system serves as a safety net for the unofficial system. In addition to unofficial agencies' obtaining regrading of samples from official agencies to measure the accuracy of their grading, official agencies' gradings are used to settle disputes between buyer and seller when an official inspection was not initially obtained. FGIS representatives said, for example, that some states require producers and elevator operators who disagree on the quality of grain established by an unofficial inspection to submit a sample for grading to an official agency to obtain a final resolution as to grade. Another example that FGIS representatives cited was a recent incident when a customer of an unofficial agency, concerned about the accuracy of the agency's grading results, submitted samples to several official agencies to clearly establish the grade for comparison purposes. In addition, FGIS representatives said, where crop conditions are poor, making the inspection function more difficult, users and unofficial agencies request more inspections than they normally do. Thus, FGIS representatives believe that, even during a period of declining official inspections, the market relies on the official system to ensure that the unofficial system is operating effectively.

Has the Decline in Domestic Official Inspections Harmed the Integrity of Shipments to Export Terminals?

The large exporters that we interviewed said that no noticeable increase has occurred in the number of shipments arriving at export terminals whose grade is incorrect. Both FGIS and state official agency representatives who perform export inspections also stated that they have noted no decline in the integrity of grain transactions.

Would Further Decline in Official Inspections Harm the Domestic Grain Industry?

Merchandisers and processors that we interviewed said they do not believe that further declines in official inspections will result in decreased integrity in domestic market transactions or impede grain marketing. Some merchandisers and processors said that there would be no adverse impact on integrity or marketing if the domestic official inspection system were abolished. But other merchandisers and processors believe that the availability of the official domestic inspection system is necessary to ensure the integrity of grain transactions and that the system's availability ultimately facilitates the marketing process.

At some point, continuing declines in the number of official inspections would hinder the financial feasibility of continuing an official domestic inspection system. However, the level of inspections necessary to support an agency would vary from agency to agency as the leadership of each agency decides what that level is for that agency. In fact, the number of inspections performed by the official agencies varied widely in 1992, ranging from under 1,000 to just over 235,000. As shown in table II.5, 16 of the 72 agencies accounted for 63 percent of the inspections.

Table II.5: Number of Domestic Inspections That Official Agencies Performed in Fiscal Year 1992

Number of Inspections	Number of agencies	Percent of Inspections	
		Total	Cumulative
Over 100,000	4	26	26
75,001-100,000	2	9	35
50,001-75,000	10	28	63
25,001-50,000	11	18	81
25,000 or less	45	19	100
Total	72	100	

FGIS representatives said that they are not sure what impact a continuing decline in use of the official system in the domestic market might have on

the integrity of grain transactions. If an agency relinquished its charter, FGIS would try to get a new agency or have an existing agency add the area to its operation.

Do Users Believe Official Inspections Should Be Mandatory?

Industry representatives that we interviewed unanimously opposed mandatory official inspections of domestic transactions. Some said that the buyer and seller for each transaction are in the best position to judge whether a third-party inspection is necessary and whether it should be an official inspection. Those interviewed generally believe that mandatory inspection is not needed and would require them to incur unnecessary cost and inconvenience in marketing their grain.

Inspection of domestically traded grain moving in interstate commerce was required by the USGSA until September 1968. At the request of USDA, in 1968 the Congress amended the USGSA to delete this requirement. In requesting the legislation, USDA stated that the requirement is an unnecessary burden on the grain industry; the inspections were often not desired by the industry, and compliance resulted in additional cost to users, particularly for transportation penalties when shipments of grain were held up to complete the inspections. USDA also asserted that the requirement was becoming unenforceable because of changing transportation patterns (i.e., increasing amounts of grain moved by truck and increasing use of special rail rates that required immediate movement of the rail cars). According to USDA, these changes made both shippers' compliance and USDA's monitoring almost impossible. Although USDA considered retaining the requirement for grain shipped by barge or by rail under conventional rates, it ultimately rejected this option as discriminatory, concluding that if the requirement was to be deleted, it should be deleted for all domestic shipments regardless of transportation mode.

FGIS representatives do not believe that official inspections should be mandatory for the domestic market. If official inspections were mandatory, FGIS representatives said that FGIS would have to provide a much more extensive oversight system.

Fees for Official Inspections in the Domestic Market

This appendix responds to the specific questions raised by the requesters concerning fees for domestic official inspections. The questions are:

- What is the cost of domestic official inspections?
- Does the new official commercial inspection offer official agencies a tool to become more competitive?
- Would AAGIWA's proposals reduce the cost of domestic inspections?
- What other options might reduce domestic inspection costs?

What Is the Cost of Domestic Official Inspections?

In 1992 official agencies charged their customers an estimated \$28 million¹ for performing domestic inspections. The agencies paid FGIS about \$1.5 million in fees for its supervision, or an average of about 5 percent of the official agencies' fees. Thus, the agencies control about 95 percent of the amount of their fees.

FGIS' supervision fee and official inspection agencies' fees are a specified amount for each type of inspection. In addition, an official agency may charge for travel time and mileage to take a sample. As shown in table III.1, when FGIS' fees are expressed as a percentage of the range of fees charged by the 70 inspection agencies,² the FGIS fees range from about 1 percent to 16 percent.

Table III.1: Range of Fees Charged by Official Agencies and FGIS' Fees

Type of Inspection	Agencies' fees		FGIS' supervision fees	Percent FGIS' fees are to agencies' fees	
	Low	High		High	Low
Truck	\$5.10	\$24.50	\$.30	5.9	1.2
Rail car	5.95	25.15	.95	16.0	3.8
Barge	106.15	283.65	6.15	5.8	2.2
Submitted sample	4.00	15.75	.30	7.5	1.9

FGIS' fee charges to official inspection agencies were limited to its costs for supervision. The charges did not include about \$2.57 million of FGIS' costs associated with oversight of the agencies; FGIS classified the activities

¹The estimate is based on each official agency's 1992 inspection activity reported to FGIS, multiplied by the price shown on each agency's fee schedule for each type of inspection for grade. The estimate excludes any additional variable charges for travel time or mileage for drawing samples, which FGIS estimates at about \$10 million. Also, the estimate excludes any charges for performing additional services, such as protein measurements or aflatoxin tests.

²Excludes the state of Alaska, which performs a limited number of inspections at no cost to the user, and one agency that performs weighing services only.

performed as quality assurance and paid the costs from appropriated funds.

Official Agency Fees

Each official agency is an autonomous entity and therefore is responsible for how efficiently and economically it operates. Each agency sets its own fees, although FGIS must approve them. FGIS' regulations require that the agency have sufficient supporting information to show how the fees were developed and that the fees are based on agency costs.

AAGIWA suggested that the official system had become encumbered with unnecessary surveys and testing that interfered with the efficient operation of the official agencies. The only example we could identify was a FGIS requirement that the agencies record separately on the inspection certificate the counts of broken corn and foreign materials present, although the two together constitute a single grading factor. According to FGIS, this requirement was instituted temporarily as part of a study made in accordance with provisions in the USGSA. This requirement was rescinded for the domestic market at the end of 1992. In our discussions with AAGIWA and with official agency representatives, we did not identify any other requirements that were considered "burdensome" or that hindered official agencies from performing efficiently.

FGIS' Supervision Fee

FGIS' supervision consists of on-site visits to observe an agency's operations, written correspondence providing guidance, and other direct dealings with the agency on a day-to-day basis. The USGSA (7 USC 79(j)(2)) requires FGIS to recoup through fees the estimated cost of its supervision of official inspection agencies. FGIS periodically reviews and adjusts its supervision fees to ensure that the fees are sufficient to cover its supervision costs. The fees are a specified amount for each type of inspection. In 1992 FGIS collected \$1.5 million from the agencies for supervision.

AAGIWA expressed concern that the FGIS supervision fee contributes to official domestic agencies' inability to compete with the costs of unofficial inspections. Most of the official agency representatives that we interviewed did not indicate that the supervision fee was a major problem.

AAGIWA also pointed out that while the official agencies must pay FGIS an inspection fee, another USDA agency (ASCS) does not require inspectors that it licenses under the U.S. Warehouse Act (7 USC 241-273) to pay a similar

fee. ASCS performs a periodic review of each grain elevator's records and inventories to ensure that the elevator can meet its obligations for delivery on demand to owners the amounts and grades of grain the owners have stored. However, ASCS does not provide any supervision to the elevators and inspectors.

FGIS' Oversight Costs

In addition to the \$1.5 million that FGIS collected from the official domestic inspection agencies for supervision, FGIS provided quality assurance oversight to the official agencies that cost an additional \$2.57 million. These costs were paid from appropriated funds. The oversight consisted of the following activities:

- FGIS' field offices oversee official agency activities, including (1) regrading samples of grain that the official agency graded to verify the accuracy of its grading and (2) performing annual management reviews (\$2.12 million).
- A FGIS headquarters unit monitors the performance of official agencies through information obtained by field offices, triennial management reviews at each agency, periodic special studies, and the triennial issuance/renewal of a charter for each agency (\$450,000).

Does the New Official Commercial Inspection Offer Official Agencies a Tool to Become More Competitive?

The new official commercial inspection has had some success. It allows official agencies to tailor the inspection requirements to their customers' needs. When approving this service, FGIS estimated that most official agencies should be able to offer the service at a cost ranging from 10 percent to 40 percent less than their fee for a standard official inspection. Many industry and association representatives that we interviewed were unfamiliar with the inspection and only one merchandiser had used it. However, the official commercial inspection enabled some official inspection agencies to obtain inspection business that they would not have otherwise obtained.

Following a test, FGIS authorized official agencies to use the new official commercial inspection in the domestic market beginning in April 1992. FGIS developed the new inspection after recognizing that the procedures governing the standard official inspection might be too stringent, time-consuming, and costly for some potential customers' needs. The official commercial inspection allows official inspection agencies to be flexible in negotiating the requirements. For example, an agency can reach agreement with a customer to deviate from the normal FGIS requirements

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in size of sample drawn or graded, can forgo retaining a file sample, and can forgo issuance of an official certificate.

Use of the official commercial inspections is increasing. For the 6-month period ended September 30, 1992, official agencies had provided about 37,000 official commercial inspections, or an average of just over 6,000 per month. Most were provided by 7 of the 72 official agencies. About 41,000 additional inspections were performed over the 4-month period ended January 1993, or an average of just over 10,000 per month. This amounts to about 5 percent of the official agencies' total inspections for the 4-month period.

Industry representatives had mixed views about the official commercial inspection. Many representatives were unfamiliar with it. For example, one person said he was unfamiliar with it but was going to call the official agency serving his area to determine why the new service had not been explained to him. A few indicated that more education about the inspection was needed. Most of the merchandisers and processors that we interviewed had not used the inspection. One merchandiser who had used the inspection said he was very pleased with the results.

Official agency representatives indicated that they had experienced mixed success with the official commercial inspection. Some said that they had obtained business they would not otherwise have had without the official commercial inspection. Several said they had offered the inspection but the industry had not indicated any interest. These same representatives generally indicated that they could not offer the inspection at a price much different from the price they charged for their standard official inspection. One representative said that he was concerned that, rather than attracting new business, the new inspection would cause current customers to switch from the old to the new service.

FGIS representatives said they were pleased with the usage of the new service. However, in their opinion, the success or failure of the service rests with the official agencies; it is largely up to them to make the service successful by offering attractive fees and marketing it aggressively.

Would AAGIWA's Proposals Reduce the Cost of Domestic Inspections?

AAGIWA suggested that FGIS could reduce its operating costs and possibly the operating costs of official agencies by

- centralizing certain quality assurance functions and
- combining USGSA's and AMA's inspection functions.

Centralize Quality Assurance

AAGIWA recommended that FGIS establish a central quality control laboratory at FGIS' Quality Assurance and Research Division in Kansas City, Missouri, to, among other things, perform some functions now performed by quality assurance units located in each field office. These functions include regrading selected samples of grain originally graded by official agencies. AAGIWA believes that the economies of scale that would result from combining the quality assurance function at one central location should permit some reduction in the total number of personnel needed to handle the work load. AAGIWA estimates that centralization could eliminate from two to four staff positions in each domestic field office. AAGIWA also pointed out that, since quality assurance functions are generally the major activity at domestic field offices, centralization should enable FGIS to consolidate more field offices.

FGIS representatives said that further centralization of the quality assurance function has been under discussion within FGIS. The function includes supervising the official agencies and regrading official agency samples. Although FGIS representatives acknowledge that further consolidations could result in some savings, they are concerned that complete centralization would unduly weaken FGIS' ability to adequately supervise official inspection agencies. Currently, field staff who perform regrading also provide supervision to the official agencies. FGIS believes that for field staff to maintain their skills in regrading so that they can provide adequate supervision to official agencies, they must continue to be involved in the actual regrading. Ultimately, FGIS representatives said, the concept must be considered from the perspective of whether it would improve the regrading portion of quality assurance without unduly weakening supervision of the official inspection agencies.

Combine USGSA's and AMA's Inspection Functions

According to AAGIWA, the grain industry can no longer afford to have a dual inspection system in place; i.e., one for grain inspection under the USGSA and another for commodity inspection under the AMA. They recommend that official agencies be allowed to conduct AMA commodity inspections as well as grain inspections, which they are not now permitted to do.

Currently, FGIS has cooperative agreements with 20 states to perform AMA inspection services. AAGIWA believes that combining the two functions would allow FGIS to consolidate more field offices, more effectively utilize personnel, and allow official agencies to operate more efficiently by performing AMA inspections when demands for grain inspection are low.

Although FGIS' field offices do much of the inspection work under the AMA, the agency does have cooperative agreements with 20 states to perform some of these services, including such things as grading rice and drawing samples of processed commodities for inspection by FGIS. Most of the inspections of AMA commodities involved 15 FGIS field offices and 4 suboffices. Of the 15 field offices, 13 also supervise official agencies or perform export inspections or both. According to a FGIS representative, if all AMA rice work could be performed by outside inspection agencies, potentially the two field offices and four suboffices, which do not have any official agency supervisory duties or perform any export inspections, could be consolidated or closed.

Under existing AMA and USGSA legislation, the Secretary of Agriculture and the Administrator of FGIS do not have the authority to create a national, unified inspection system. At present, the inspection of grains is conducted under authority of the USGSA, and the inspection of certain other commodities (such as beans and lentils) is conducted under the AMA. The fact that an organization is an official agency under the USGSA for the purpose of inspecting grain confers no special status with respect to the inspection of commodities under the AMA. The AMA provides no authority for the Secretary of Agriculture or the Administrator of FGIS to amend the designation of official agencies under the USGSA to include commodities, such as beans, covered by the AMA.

The AMA (7 USC 1624(a)) does provide the Secretary with the authority to:

...enter into contracts and agreements under the terms of regulations promulgated by him with States and agencies of States, private firms, institutions, and individuals for the purpose of conducting research and service work, making and compiling reports and surveys, and carrying out other functions relating thereto when in his judgment the services or functions to be performed will be carried out more effectively, more rapidly, or at less cost than if performed by [USDA]. . . . (Underscoring added.)

Under the AMA, the Secretary would have to decide whether to enter into arrangements with private firms to perform AMA inspection services. FGIS' position is to be supportive of efforts to allow official agencies to handle

AMA commodity inspections. According to FGIS, the skills and knowledge used for grading grain and edible beans, peas, and lentils are very similar. However, FGIS representatives pointed out that, if AMA inspections are opened to private firms, official agencies would have to compete with any other qualified applicants to perform the inspections.

What Other Options Might Reduce Domestic Inspection Costs?

Industry and association representatives suggested that the solution to reducing costs and fees for domestic official inspections is to introduce more competition into the fees. Currently, each of the 72 official agencies is assigned an exclusive geographical service territory. Any customer desiring an official inspection in a specific geographical area must pay the fee set by the official agency serving that area.

The USGSA (7 USC 79(f)(1)(A)(v)) specifies that official agencies will not charge inspection fees that are "unreasonable," but the act does not define what is unreasonable. FGIS' implementing regulations essentially require that each official agency's fees must be supported by sufficient information showing how the fees were developed and must be based on its costs. According to those regulations, one test of reasonableness is whether the fees are reasonably consistent with fees assessed by adjacent official agencies for similar services. Nonetheless, official agency fees vary substantially among agencies serving contiguous areas. For example, one agency charged \$6.50 to sample and grade a truckload of grain, while an agency serving an adjacent area charged \$8.85 per truck. One agency charged \$23.70 to sample and grade the grain in a rail car, while four agencies in adjacent areas charged \$9.45, \$10.70, \$11.15, and \$18.20.

A few official agency representatives stated that fee competition exists now in that, if agencies' fees are too high, they risk losing business to unofficial inspectors. FGIS supported this position in a letter to a grain industry association, dated August 1992. The association had recommended that FGIS consider allowing more than one agency to provide service in an area as a means of introducing competitive pricing. However, FGIS' response does not discuss the fact that potential customers who elect to get an unofficial inspection, because the official inspection is not competitively priced, must also forgo the benefits of an official inspection.

Industry associations supported two options for bringing more competition into the process for setting official domestic inspection fees:

-
- Make fees a major consideration in making the decision as to who receives an official agency charter and as part of the charter designation renewal process.
 - Eliminate exclusive service territories for the official domestic inspection agencies.

One large merchandiser said that, while he supports more competitive official fees, he is not sure that he would like to see ownership of official agencies changing every 3 years if that would be the outcome of a more competitive system. He said that there are some merits in having stable ownership and in building good working relationships with the industry.

FGIS is concerned that any increased regulatory effort on its part to oversee official agencies' fees could be viewed as setting rates, which would result in additional regulatory requirements. FGIS does not view additional regulation as desirable.

Charter Designation Process

In the charter renewal process, FGIS has the authority to determine to what extent fees should be a consideration and who receives an agency charter.

The USGSA limits charters for official agencies to a period of 3 years (7 USC 79(g)(1)). The congressional committee reports accompanying the USGSA of 1976 indicate that the automatic expiration provision was included to give FGIS an opportunity to evaluate each agency's overall performance and compliance with eligibility criteria set out in the act. These criteria (7 USC 79(f)(1)) include such things as whether the applicant has adequate facilities and qualified personnel, will meet training requirements, will comply with regulations, has no conflicts of interest, and will not charge fees that are discriminatory or unreasonable. This section of the act also gives the FGIS Administrator broad discretion in making the charter designation by stating that, in addition to the specific criteria contained in the act, the Administrator must determine that the applicant ". . . is better able than any other applicant to provide official inspection service."

As part of the triennial evaluation process, FGIS publishes a notice in the Federal Register inviting applications from interested parties. In completing the application, each applicant must show its proposed fee schedule for official services. The FGIS' regulations for making designations state that the application will be reviewed to determine whether each applicant meets the conditions and criteria for designation set out in the act. FGIS has no other published criteria for reviewing the applications and

making the designation decision. FGIS representatives involved in the evaluation process indicate that some preference is usually given to the incumbent if all other considerations are equal. Overall, competition for the charters has been limited. For example, as of August 1992, applications were received from other than the incumbent for only 13 of the 72 charters when each last came up for renewal.

Service Competition

The USGSA (7 USC 79(f)(2)) requirement that each official domestic inspection agency will serve an exclusive territory frees the agency from any competition from other designated official agencies. Although two industry associations have recently recommended to FGIS that exclusive official service territories be eliminated to create some price competition, the USGSA does not give FGIS authority to make such a change.

The provision for an exclusive territory was added to the act in 1968 at USDA's recommendation. In its request for the legislation, USDA stated that the provision was needed to avoid "undesirable competition" between inspection agencies, although it did not elaborate on what was undesirable. This provision merely codified agency practice. In 1976 amendments the Congress made this section of the act even more restrictive by adding a requirement that an official inspection can be performed only by the official agency serving the geographic area where the sample is drawn. The conference report concerning the 1976 amendments states that this modification was made to prevent the practice of "grade shopping," i.e., to prevent a customer from continuing to get official inspections from different official agencies on the same load of grain for the purpose of ultimately obtaining the grade the customer desired.

FGIS' Fees for Export Inspections

This appendix responds to the specific questions raised by the requesters concerning the costs of FGIS' export inspections and potential options to reduce those costs. These questions are:

- Are FGIS' charges to the export inspection program appropriate?
- How do the costs of FGIS' and states' export inspections compare?
- What options might reduce the cost of FGIS' export inspections?

Are FGIS' Charges to the Export Inspection Program Appropriate?

Our review of FGIS' accounting records indicates that direct costs charged to the FGIS services-performed account for 1992, which is predominantly FGIS' export inspection activity, were appropriate. However, FGIS used a questionable methodology to distribute indirect costs, which may have resulted in undercharges of \$695,000 to the account for 1992.

FGIS records expenses and fee income to the FGIS services-performed account for services performed in the United States by FGIS staff under the USGSA. The services include export and domestic grain inspections and observation of weighing, testing for various attributes (e.g., the presence of protein, oil) or substances (e.g., the presence of aflatoxin), ship stowage examinations, and conducting appeal inspections. The USGSA (7 USC 79(j)(1)), as amended, directs FGIS to charge and collect fees to cover the estimated cost of official inspections that "... shall, as nearly as practicable ... cover the costs ... [of such services] including administrative and supervisory costs related to such official inspections of grain."

In 1992 FGIS showed income of \$19.1 million for services it performed and expenses of \$18.8 million, indicating that fees were sufficient to cover FGIS expenses. The \$18.8 million in expenses consisted of \$17.1 million in direct costs and \$1.7 million in indirect costs. FGIS' accounting records do not segregate revenues (or costs) by type of service or by export and domestic activity. However, our review of the records and discussions with FGIS officials indicates that virtually all of the costs charged to the account were charged by FGIS field offices that performed export inspections and weighing. For example, while FGIS reported that it performed about 82,000 official inspections in the domestic market in 1992, almost all of these inspections were performed by export field offices. FGIS representatives said that the only domestic inspections that export field offices were likely to have performed would have been on in-bound grain shipments at export elevators. Accordingly, they said, the inspections would have been performed by the same FGIS crews doing the export inspections for the

same elevators. Therefore, such domestic inspections were related to the export operation and not to any separate domestic activity or customer.

Our review of FGIS' allocation of indirect costs to the FGIS services-performed account for 1992 disclosed that FGIS used a questionable methodology. The methodology includes averaging several unweighted percentages as a part of the allocation process. If the percentages had been weighted by the dollar value of the universe they represented, the indirect charges to the FGIS services-performed account would have increased by \$695,000. In view of our disclosure, the FGIS Acting Administrator said that the agency would review its methodology for allocating indirect costs.

How Do the Costs of FGIS' and States' Export Inspections Compare?

Our analysis indicates that FGIS' charges for inspecting and weighing export grain for 1992 averaged an estimated .47 cent per bushel while the eight state agencies charged an average of .41 cent per bushel. To ensure that the quality of grain exported is correctly represented, the Congress in the 1976 act required that shipments of grain of a specified grade for export be inspected and weighed at the export terminal. FGIS performed about 82 percent of the export inspection and weighing services in 1992.

Of the \$14.5 billion in grain exports¹ that FGIS and state official agencies inspected and verified weight for, the exporters paid FGIS \$14.9 million and paid the state agencies \$2.8 million for a total of about \$17.7 million in 1992, or about one-tenth of 1 percent of sales. This amount includes charges for inspection and weighing required by the USGSA for all grain exported, but it does not include any additional services, requested by exporters, such as testing for wheat and soybean protein content and soybean oil content, or measuring for the presence and amount of aflatoxin.

To compare FGIS' and states' inspection fees, we calculated an average price per bushel for both FGIS and the eight state agencies. The eight states charge by the bushel or short ton, which ranges from three-tenths to nine-tenths of a cent and averages .41 cent per bushel. FGIS' export inspection fees are expressed in hourly rates per person needed to perform the inspections at each location. To estimate the FGIS cost per bushel, we subtracted the \$4.2 million for services other than the required inspections and weighing from the total \$19.1 million in fee collections in

¹The total bushels for each type of grain that FGIS and state official agencies inspected and weighed for export multiplied by the average sales price provided by USDA's Economic Research Service for 1992.

the FGIS services-performed account. We then divided the \$14.9 million in fees for required inspection and weighing services by the number of bushels inspected, which showed that FGIS charged an estimated average of about .47 cent per bushel.

What Options Might Reduce the Cost of FGIS' Export Inspections?

Although we found no comparative criteria for judging whether FGIS' inspection charges for grain exports are more than exporters might pay under some other arrangement, the two large grain exporters that we interviewed would like to see the cost of export inspections reduced. While one believes the legally required inspection is unnecessary, the other believes it is needed. To reduce inspection and weighing costs, AAGIWA and exporters have suggested that these services now performed by FGIS be performed by additional state-operated as well as by privately owned inspection agencies. FGIS may delegate its authority to state government agencies to perform the required inspection and weighing services under FGIS supervision, if the agencies meet specified requirements of the act. Under delegations from FGIS, eight state agencies perform export inspection and weighing services.

Exporters' Views on Required Export Inspections

According to representatives of two large grain exporters that we interviewed, in today's competitive world grain market, they must ensure that they deliver the grade and quality of grain specified in the sales agreement, or their customers will purchase grain from other sources. Nonetheless, they had different views about whether it is necessary to continue the legally required official export inspections. One exporter said that he believes the official export inspection is a selling point in overseas markets and that there is value in retaining an independent export inspection, either as a sales tool or as a means of maintaining discipline on the industry. The other said that he believes the company's reputation is a more important factor in making sales and that the independent inspection is not very important. They explained that most exporters have instituted internal quality assurance controls to ensure that the grain delivered is as specified in the sales agreements. Furthermore, when questions arise about the grade, quality, and weight of a transaction, the exporters said they must satisfy the buyer regardless of what the official inspection certificate shows or risk losing the buyer's future business.

One association representative said that small and medium-size grain exporters may place a higher value on the required official export inspections than do large exporters. He pointed out that smaller exporters

probably lack the financial resources and reputation necessary to provide the assurances needed to most effectively compete against large exporters in the export market. However, he explained, the required official inspection provides all foreign buyers with assurances as to the grain shipped to them, regardless of the size of the exporter.

FGIS believes it is in the best interest of U.S. agriculture to retain an export inspection program to assure foreign buyers of the quality and quantity of the grain being shipped to them. FGIS believes that, over the years, events have demonstrated the importance of mandatory inspection to ensure fair and equitable assessment of export grain. Moreover, FGIS believes its export inspection process ensures a fair and equitable process for measuring grade and quantity.

Reducing FGIS' Export Inspection Charges

AAGIWA and grain industry representatives said that, because FGIS has limited potential to reduce its costs, FGIS should discontinue performing the export inspection and weighing and permit those activities to be performed by additional state-operated as well as private inspection agencies. They believe that state or private agencies could charge less than FGIS because their personnel costs would be lower and their policies and rules on utilizing staff would be more flexible.

AAGIWA and grain industry representatives have concluded that FGIS probably cannot make further material reductions in the cost of its export grain inspections because of high federal personnel costs and because of inflexible federal work rules that do not allow sufficient flexibility to most effectively utilize staff. FGIS representatives said that the assumptions that federal personnel costs are higher are valid to some degree. For example, a FGIS representative said that federal pay and benefits are probably higher than most private and state-operated official agencies. Under federal regulations FGIS must also give employees 60 days' notice on layoffs and must pay premiums for night, Sunday, and holiday work, whereas private employers are not required by law to do so. Overall, FGIS representatives agree that there is little opportunity for further significant cost reductions in their export inspection program.²

²In 1992 FGIS had nine field offices and three suboffices that performed export inspection and weighing. Most FGIS inspections (97 percent) in 1992 were performed by export offices located in three states (Louisiana, Oregon, and Texas). In the last 2 years, FGIS has closed two export offices, and according to FGIS officials, they are continuing to analyze work loads to see whether they can make further consolidations that would reduce costs.

Whether the performance of export inspection and weighing services exclusively by state and private agencies would result in lower costs is not clear because no comparative cost study has been made. However, FGIS' supervision fees would have to be added to state or private agency fees, which could increase the combined costs above those now charged by FGIS. FGIS representatives said that their fees would depend on the amount of supervision that would be necessary.

There is no provision in the USGSA for export inspections to be performed by privately owned inspection agencies. Nonetheless, if the act were changed, FGIS representatives said that the USGSA provides sufficient authority for them to effectively monitor the agencies and enforce compliance with inspection and weighing and related requirements, including conflict of interest.³ This is possible because of the changes made in the USGSA of 1976 to curb the serious inspection and weighing abuses identified in the mid-1970s. These amendments gave FGIS strong authority and supervisory control over the official agencies, provided more stringent controls over conflict-of-interest issues, and required 100-percent observation of weighing of grain as it is loaded onto vessels.

The USGSA of 1976 also placed restrictions on states for qualifying as a delegated agency. Most of the irregularities identified in various investigations involved private agencies, many with conflicts of interest. The Congress therefore authorized FGIS to delegate its authority only to state-operated inspection agencies that were performing official export inspections on July 1, 1976. Although subsequent amendments modified the qualification requirements to some degree, state agencies could be approved in only those instances in which total state grain exports did not exceed 5 percent of the total annual grain exports from the United States.

FGIS opposes the delegation of export inspection and weighing to additional states and to privately owned inspection agencies, at the major export locations now serviced by FGIS. FGIS pointed out that the current user-fee arrangement has been in place for 17 years and that during that period FGIS has developed a streamlined inspection and weighing process resulting in a high level of productivity. Furthermore, FGIS does not believe state and private agencies could perform the services at less cost.

³Conflict of interest generally means that an operator or member of an official agency are also employed by a grain business, accept gratuities from such a business, or have a financial interest in a grain business, or that owners of a grain business are employed by, have a financial interest in, or give gratuities to an official agency.

List of Industry Associations Contacted

American Association of Grain Inspection and Weighing Agencies

American Corn Millers Federation

American Feed Industry Association

American Soybean Association

Corn Refiners Association

Millers' National Federation

National Association of Wheat Growers

National Corn Growers Association

National Grain and Feed Association

National Grain Sorghum Producers Association

National Oilseed Processors Association

Terminal Elevator Grain Merchants Association

U.S. Wheat Associates

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